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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**Date Issued:** January 22, 2010

**IBA Report Number:** 10-07

**Budget and Finance Committee Meeting Date:** January 28, 2010

**Item Number:** 3

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# Update on City Budget Policy

## OVERVIEW

The City's Budget Policy establishes guidelines for budget development, budget monitoring and fiscal planning, and sets standards for sound budgetary practices. The Budget Policy serves as a useful tool to the City in maintaining and improving its fiscal health.

On Monday, October 26, 2009, the City Council approved amendments to the City of San Diego Budget Policy (Council Policy 000-02, entitled Budget Process – City Budget Policy.) The amended policy was adopted with direction from the Council that outstanding issues related to performance measures and funding of retiree health care costs be referred to the Budget and Finance Committee. Additionally, it was requested that consideration be given to include additional financial reporting requirements in order to comply with Charter Section 39.

This report provides an update to the Budget and Finance Committee on the status of these outstanding issues related to the Budget Policy, and includes related developments and changed circumstances since the Council's action in October 2009. As work has begun on the development of a Structural Budget Deficit Elimination Plan, important discussions will be occurring in the months ahead to formulate the City's policy position in many areas, impacting the City's Budget Policy. This report concludes with the IBA's recommendation to defer changes to the City's Budget Policy, until critical positions can become more fully developed in the months ahead amid discussions of budgetary solutions.

## FISCAL/POLICY DISCUSSION

### Linking Budget Priorities/Process to Performance Measures

Prior to the City Council's approval in October 2009, the Budget and Finance Committee requested the IBA to develop an option to amend the policy to address how information on service levels and performance outcomes could be improved and utilized as a driver of the budget process and related decisions.

In response to the request, the IBA developed a course of action to move towards a more fully integrated budget development process using performance measures and addressing the Council's priorities. This was provided as Attachment 1 to IBA Report No. [09-83](#). In summary, the proposal outlined a process to more fully utilize the City's current 38 key city-wide performance measures, including reporting of related performance data to the Council each December, and to incorporate an annual Council resolution by early February each year to inform the Mayor on the levels of service they desire to see carried out for the next fiscal year. Using this input, the Mayor can then develop his proposed budget, and describe how these priorities are met, or where gaps may exist.

The proposal provided an opportunity to articulate a strong connection between the City's Strategic Plan, performance measures and annual budget decisions as well as outlined a more strategic approach to goal setting and budget decision making between the two branches of government.

At the October 2009 Council meeting, it was recommended that the performance measure issue be referred to the Budget and Finance Committee for further discussion and action.

Since that time, in our December 2009 report on the budgetary solutions for Fiscal Years 2010 and 2011 (IBA Report No. [09-90](#)), we discussed that a wide range of services are expected to be revised, reduced or eliminated, and service levels and related performance measures are in flux, due to significant mid-year budget reductions. The Mayor's budget reduction proposal attempted to characterize the related service level impacts to the best of staff's ability, under tight time constraints.

Assistant Chief Operating Officer Wally Hill is responsible for overseeing the City's Strategic Plan and related performance measures. Mr. Hill has indicated that, following Council's action on the Mayor's budgetary reduction proposal, work to revise and update the City's Strategic Plan, goals, objectives and performance measures is to begin. The IBA believes the Council should be updated on this process through the Budget and Finance Committee.

Ideally, updated and quantifiable performance measures would be integrated with specific budget proposals and be available to inform the Council's budget decisions. However, the City's performance measurements are not truly embedded in the budget

process. Under normal circumstances, an annual performance report would be provided to the Council in March 2010 to inform the FY 2011 budget process. However, data available now will most likely not reflect recent budget actions and will not be meaningful. Furthermore, additional budgetary reductions are expected to be necessary in the months ahead.

Based on the varying implementation schedules for the budget reductions and the time needed to collect meaningful data, we had recommended that the Mayor's Office provide a mid-FY 2011 comprehensive and updated performance status report in January 2011 based on activity through December 31, 2010. In the interim, the Mayor should communicate with the City Council during the Strategic Plan revision process; and after reductions have been implemented for several months, Council Committees may want to separately docket discussions of various programs that have taken reductions in order to learn more about the impacts being felt by the community as well as the departments.

This revised plan does not follow the timeline of the IBA's original proposal for reporting of key measures by December, and obtaining Council input in early February. In the future, the IBA intends to recommend memorializing an annual process, mirroring the original proposal, as part of the City's Budget Policy, but recognizes the inability of the City to accomplish this now.

#### Policy for Funding Retiree Health Care Costs

Another outstanding issue relates to the funding levels for retiree health care costs. The IBA had suggested that the City's Budget Policy could state that: "The City intends to fund annual pay-as-you-go costs and an amount for pre-funding future liabilities for retiree health, in total, at an amount which is at least 50% of the OPEB ARC." This would be consistent with current funding levels. In addition, the IBA suggested that language could be added to say that this is a short-term solution until retiree health study currently underway is completed, and the City's Budget Policy could be reviewed to address the study results, by January 2012. At the October 2009 City Council meeting, it was directed that the policy for funding retiree health care costs be referred to the Budget and Finance Committee for a full discussion.

In addition, Councilmember DeMaio requested that the City's Budget Policy be amended such that the section related to the Five-Year Financial Outlook should include the following amounts for each of the forecast's five years for retiree health care: the Annual Required Contribution (ARC); pay-as-you-go costs; and the unfunded liability, based on the following two scenarios:

1. Based on current funding strategy of pay-as-you-go amount plus some additional amount for pre-funding future liability for retiree health (lower than the ARC)
2. Based on payment of the full ARC each year

Relying on a review of the Council meeting minutes, and the current version of the City's Budget Policy available on the City's website (attached), it is unclear if the amended

Policy was adopted with the changes as requested by Councilmember DeMaio. Based on input and direction from the Budget and Finance Committee, the IBA can work with Financial Management staff to incorporate these revisions at a future date, if desired.

We understand that work is underway on the joint study of retiree health care by City management and its labor organizations. It is hoped that changes to retiree health care benefits can be successfully negotiated which will reduce the City's current and future liabilities in this area, and can affect the level of funding to be included each year in the City's budget. Until more work is completed in this area, the IBA suggests that a policy statement should be deferred.

#### Reporting Requirements of Charter Section 39

Also at the October 2009 Council meeting, Councilmember Frye requested the City's Budget Policy reflect that monthly financial reporting as required under Charter Section 39 include component units as shown in the City's financial statements (Redevelopment Agency, Southeastern Economic Development Corporation, Centre City Development Corporation, San Diego City Employees' Retirement System, San Diego Convention Center Corporation and San Diego Data Processing Corporation). At present, this type of information for the component units is provided on a quarterly basis, as part of the monthly financial performance reports as prepared by the Office of the City Comptroller. Councilmember Young expressed his support and agreed that this issue could be discussed at a future Budget and Finance Committee meeting.

## CONCLUSION

This report provides an update to the Budget and Finance Committee on the status of outstanding issues related to the Budget Policy, and related developments and changed circumstances since the Council's action to amend the City's Budget Policy in October 2009.

Recent budgetary changes will affect the levels of service to be provided by the City, and in turn, impact the expected and actual performance measures of most departments. It is anticipated that additional budgetary reductions will need to be implemented relatively soon. Additionally, we understand that work is underway on the joint study of retiree health care by City management and its labor organizations. It is hoped that changes to retiree health care benefits can be successfully negotiated which will reduce the City's current and future liabilities in this area, and can affect the level of funding to be included each year in the City's budget.

Work has also begun on the development of a Structural Budget Deficit Elimination Plan, which includes guiding principles, currently in draft form. Critical discussions will be occurring in the months ahead to formulate the City's policy position in many areas, impacting the City's Budget Policy.

The IBA believes that further work on the City's Budget Policy at this point is premature, and that work instead should be focused on developing the City's budgetary solutions and determining its official policy position, once key studies and negotiations have been completed, particularly in the area of retiree health care. Once progress is made, changes to the City's Budget Policy can be developed to align the policy with the positions that are hoped to be more fully developed during this critical period.

**[SIGNED]**

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Elaine DuVal  
Fiscal & Policy Analyst

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APPROVED: Andrea Tevlin  
Independent Budget Analyst

Attachment: City Budget Policy